Quiz 5 Name:____________________________________

Microeconomics - EC 2106

Instructor: Robert McNab Score:________________

INSTRUCTIONS: Please answer all questions to the best of your ability within the allotted time of 15 minutes. You are required to show your work to receive credit. For multiple choice and true/false questions, please circle the appropriate answer. 20 possible points.

1. In your own words, describe the difference between economies of scale and economies of scope. 3 points

2. Provide a numerical example of the difference between economic and accounting profit. Ensure that you define and highlight the difference between explicit and implicit costs. 5 points.

3. In your own words, explain how a firm might use the price elasticity of demand measure to increase profitability. 2 points.

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1. In your own words, describe the difference between economies of scale and economies of scope. 3 points

Economies of scale in production or distribution occur when average costs decline as a result of expansion of production or distribution, that is, average costs decline as a firm increases in size. Economies of scope, on the other hand, occur when a firm realizes lower costs by producing or distributing similar products that utilize the same production technologies or distribution networks.

2. Provide a numerical example of the difference between economic and accounting profit. Ensure that you define and highlight the difference between explicit and implicit costs. 5 points.

Assume that you quite a $50,000 a year job to start your own consulting business. Your total sales after the first year are $125,000. Your total explicit costs (taxes, wages, salaries, benefits, materials, travel, etc) equal $90,000. Your total implicit costs are the opportunity costs of resources that you supplied which do not require direct cash outlays, or $50,000 (the salary foregone).

Accounting profit is : *$125000 - $90000 = $35,000*

Economic profit is: *$125000 - $90000 - $50000 = -$15,000*

Thus, from an economic perspective, you would be better off by returning to your old job, all else remaining equal.

3. In your own words, explain how a firm might use the price elasticity of demand measure to increase profitability. 2 points.

Price elasticity of demand can illustrate the responsiveness of demand to changes in price. Thus, if a firm has sufficient information to calculate the price elasticity of demand, they can determine whether the product(s) they are selling are price elastic, price inelastic, or unitary price elastic. If the price elasticity measure is greater than 1, the firm has information that if they lowered the price of the product, quantity demanded and total revenue would increase. Conversely, if price elasticity of demand is less than 1, then the firm knows that lowering prices would lead to a decline in total revenue.